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Supreme Court of the United States

OCTOBER TERM, 1960.

No. 843

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

MILWAUKEE & SUBURBAN TRANSPORT CORPORATION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

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OPINIONS BELOW.

The memorandum opinion of the Tax Court (App. A of Petition pp. 10-41), T. C. Memo 1959-216, is not officially reported. Unofficial reports are found at 18 TCM 1039 and 1959 P-H TC Memo Dec. ¶ 59,216. The opinion of the Court of Appeals (App. A of Petition pp. 42-60) is reported at 283 F. 2d 279.

The printing of the opinion of the Court of Appeals in Appendix A of the Petition contains a confusing typographical error. At page 54, the fourth line from the bottom, the word "not" should be deleted. Corrected, the phrase reads, "it is the opinion of the court that petitioner's method of accruing its estimated liability does clearly reflect its income on an annual basis."

QUESTION PRESENTED

The taxpayer, a municipal transit company filing its federal income tax returns on an accrual basis, regularly employs in keeping its books a generally accepted method of accounting, standard in its industry, which involves accruing each year the estimated amount of incurred liability for injuries and damages arising out of accidents which occurred that year but were unsettled as of the close of the year. As claims are disposed of in subsequent years any net difference between estimated and settled liability is taken into account in the year of disposition.

The Circuit Court of Appeals in its decision quoted with approval the statement of the question set out by the Tax Court. It is as follows:

> "The question here presented is whether petitioner, an accrual basis taxpayer, may deduct for each of the years 1953 and 1954, certain amounts accrued by it on its books of account as of December 31 of each year. Such amounts represented its estimate of the probable amounts which it would have to pay in settlement for personal injuries and property damages, arising out of accidents in which its employees and equipment were involved."

For reasons of its own, the Government chose to alter that question.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1939 and Treasury Regulations thereunder are printed in Appendix B of the Petition, pp. 67-66. The pertinent provisions of Sections 162, 446 and 461 of the Internal Revenue Code of 1954 and Sections 1.446-1 and 1.461-1, Treasury Regulations on Income Tax (1954 Code), are printed in an Appendix C appended hereto.

STATEMENT

This case does not, as the Government states (Petition pp. 2, 4, 6, 8), involve an addition to a "reserve"; it involves accrual of the estimated amount of liabilities already incurred although not yet settled. Historically, in the decisions of this and other courts, the difference has been critical. The two situations ought not be confused. It is therefore necessary to restate the facts.

The taxpayer, a Wisconsin corporation, operates the transit system in and around Milwaukee, which it acquired by purchase of assets on December 30, 1952. It files its returns on a calendar year and accrual basis. During 1953 and 1954, it operated approximately 1,000 vehicles, carrying from 250 to 281 million passengers annually. Its vehicles were involved in 5,903 accidents in 1953 and 5,044 accidents in 1954. (Petition p. 2; Pet. App. A pp. 20, 43, 50-51.)

So far as here material taxpayer was a self insurer of its accident liabilities. It maintained a staff of attorneys and claims adjusters to investigate, settle and defend claims for personal injuries and property damages. As of December 31, 1953, there were 414 unsettled claims from accidents occurring in that year; at the end of 1954 there were 447 unsettled claims arising out of accidents in that year. (Petition pp. 2-3.)

At the end of each year, taxpayer's Board of Directors appointed from their number a committee of three (two of whom were attorneys) to examine the information gathered by its attorneys and claims adjusters relating to each of the unsettled claims. The committee made an appraisal or estimate of the amount for which, in their opinion, the taxpayer was liable, if at all, in each instance. The total estimated amount was set up on the taxpayer's books of account as a book liability for unsettled claims for injuries and damages. This amount was $254,659 for 1953 and

$161,136.50 for 1954. (Petition p. 3; Pet. App. A pp. 31, 51.)

Taxpayer's general claims agent was in each year authorized to settle the pending claims at the amounts at which they had been appraised, but taxpayer did not at any time notify or otherwise admit to any of the claimants that it considered itself liable. The appraised estimates were kept confidential and taxpayer's agents tried to settle claims at the lowest possible figure. (Petition pp. 3-4.)

The aggregate estimated liability so determined was accrued on taxpayer's books as an expense and a liability at the end of each fiscal year. As payments were made in future years in settlement of these liabilities, the amount thereof was charged to the accrued liability and was not charged to expense in the year of settlement. Accidents were considered settled when agreement was reached with the injured person, or upon conclusion of any litigation, or if no claim was filed within the two year statute of limitations applicable under local law. Any net difference between liability as appraised and as finally determined was reflected in book and taxable income in the year of settlement.[1] (Petition App. A pp. 32, 42; R. 110, 113.)

Taxpayer's method of accounting for its liabilities for injuries and damages unsettled at the close of the year in which the accidents occur is in accordance with generally accepted principles of accrual accounting, has been consistently applied by the taxpayer since it first commenced business and is the recognized and accepted method of accounting for such liabilities in the transit industry. (Petition App. A p. 55; R. 103-104, 107.)

In filing its federal income tax returns taxpayer accounted for its injuries and damages liabilities unsettled

1. This method of adjusting such differences is specifically required and authorized by Treasury Regulations Sec. 1.461-1 (a) (2). (Appendix C, *infra*, pp. 23-24.)

at the close of the year in which the accident occurred in accordance with the same method which it used to compute its income in keeping its books. The resulting deductions were $254,659 for 1953 and $142,022.87 for 1954, the latter figure computed as follows: (Petition p. 5; Petition App. A pp. 32, 52):

Appraised liability on unsettled claims, 1954 accidents		$161,136.50
Deduct: Appraised liability of 1953 claims settled in 1954	$94,984.00	
Less: Amounts at which 1953 claims were actually settled	75,870.37	
		19,113.63
Net amount expensed and added to liability account, 1954		$142,022.87

At the time of trial all but 8 of the 1953 claims and all but 13 of the 1954 claims had been settled. According to the best evidence available at times of trial, taxpayer's liability on unsettled 1953 claims (originally estimated at $5,200) was $14,500 and its liability on unsettled 1954 claims (originally estimated at $12,750) was $51,415. (Petition p. 4; Petition Exhibit A pp. 35, 53; R. 87-89.)[2]

The Commissioner disallowed the entire amount of $254,659 deducted by taxpayer in 1953 and $61,473.79 of the $142,022.87 deducted by taxpayer in 1954 under its method of accounting for these liabilities. The Commissioner allowed as a deduction only the amount of these claims which were actually settled or paid in each year, namely, none in 1953 and $80,530.08 in 1954. (Petition p. 5; Pet. App. pp. 32-33, 52.)

2. The revised estimate figures stated in the Tax Court opinion and quoted by the Court of Appeals differ from the figures stated here and in the testimony by $3,500 in 1953 and $1,000 in 1954 because of one case in each year pending at date of trial but not appraised at the close of the accident year. R. 87-89.

Viewing each claim separately, taxpayer's estimates of liability varied substantially from the liability finally determined. (Petition p. 4.) However, viewed in the aggregate, taxpayer's actual liability (actual settlements plus currently revised estimates of the few remaining unsettled claims) compares with the deduction claimed by taxpayer under its method of accounting and with the deduction allowed by the Commissioner as follows (Petition pp. 4, 5; Petition App. A pp. 32, 35, 36, 52, 53; R. 87-89; See also Footnote 2, p. 5):

	Actual Liability	Taxpayer's Deduction	% to Actual	Commr's. Deduction	% to Actual
1953	$196,230.24	$254,359.00	130%	—0—	00%
1954	212,266.84	142,022.87	67%	$80,550.08[3]	38%
Total	$408,497.08	$396,681.87	97%	$80,550.08	20%

A comparison of the accuracy of the respondent's method with that contended for by the Commissioner thus indicates that while the respondent's method results in a determination which was 97% of the final determination, the Commissioner's method results in a determination which is only 20% correct when measured against the final liability.

The Tax Court sustained the Commissioner. (Petition App. A pp. 36-41.) The Court of Appeals reversed. (Petition App. A pp. 50-60.)

3. The difference between the 1954 settlements of 1953 cases ($75,870.37) and the deduction allowed by the Commissioner ($80,550.08) is not explained by the record. It is apparently attributable to payments in 1954 in partial satisfaction of liability on 1953 accidents (medical expenses, etc.) in cases where total liability was not settled until a later year.

SUMMARY OF ARGUMENT.

Respondent opposes the granting of a petition for certiorari in this case for the following reasons:

(1) The decision of the court below is limited to an almost unique set of facts, has no general application, and does not involve an important question of federal law.

(2) The decision is not in conflict with the decision of any other circuit, nor does it conflict with any decision of the Seventh Circuit.

(3) The decision does not conflict with any applicable decisions of this Court; as a matter of fact it follows the applicable decisions of this Court.

(4) The question presented in this case is not related to questions involved in the two cases referred to as awaiting argument in this Court (*American Automobile Association v. United States*, No. 288; and *United States v. Consolidated Edison Co. of New York*, No. 357).

(5) The decision of the court below is not in derogation of the annual accounting rule but is an excellent exemplification of that rule.

(6) The reference in the Government's petition to the now repealed Section 462 of the Internal Revenue Code of 1954 indicates a misconception of the issue presented herein, and the obvious distinction between that issue and the section cited.

ARGUMENT IN OPPOSITION TO GRANTING THE WRIT.

The holding of the Court of Appeals in this case is extremely limited and depends on a conjunction of facts far too unusual to warrant review by this Court on certiorari. Not except by gross generalization may the issues in this case be related to the issues in the two cases cited by petitioner in which certiorari has been granted and the

four in which petitions are pending. All involve the broad topic of accounting methods but no holding in those cases is likely to have application to this one, or vice versa.

So far as has been disclosed by the briefing of both parties in both courts below, this case presents a factual situation which has been the subject of reported tax dispute only once before since the beginning of the income tax law. That was 30 years ago in *Ocean Accident & G. Corp. v. Commissioner*, 47 F. 2d 582 (CA 2, 1931), dealing with the years 1918-1920.[4]

The peculiar factors involved in the present case are:

(1) the deduction of an aggregate of estimates of liabilities already incurred (as distinguished from a reserve based on prediction of liabilities likely to be incurred in the future),

(2) where the number of items making up the aggregate is sufficiently large to permit of a reasonable estimate of the aggregate despite the uncertainties inherent in each item taken alone,

(3) where it is established that such is a generally accepted method of accounting for such items, standard in the industry involved, on the basis of which the taxpayer regularly computes its income in keeping its books, and

(4) where no *change* of accounting method is in-

4. Commencing with the next year, 1921, insurance companies have deducted such liabilities under special statutory provisions which have eliminated any need for further testing by them of the general statutory provisions applicable here and in *Ocean Accident*. Section 246 (b) (6) of the Revenue Act of 1921, continued as Section 204 (b) (6) of the Internal Revenue Code of 1939 and as Section 832 (b) (5) (B) of the Internal Revenue Code of 1954. Contrary to the statement in the petition (Petition pp. 4-5) *Ocean Accident* did not turn on provisions peculiar to insurance companies but rather presented a pure question of accrual identical to the one here presented. See pp. 18-19 hereof.

volved. (Thus the Commissioner's plenary power to consent or not, to accounting method *changes*, is not involved.)

No reported case, other than this one and *Ocean Accident*, presents such a situation. The group of accounting method cases now pending before this Court present distinctly different facts and questions. Petitioner has made no showing of even one case now pending anywhere in the United States involving the same or even closely similar facts and circumstances. Respondent knows of none. Only two such cases have been litigated since the excise (income) tax levied upon corporations by the Act of August 5, 1909 (36 Stat. 113). Two Courts of Appeals have passed on the question. Their decisions are in perfect harmony, not in conflict. The mere possibility that a similar situation may perhaps arise sometime in the next thirty or forty years is scarcely enough to convert the dispute between these present litigants into an important question of federal law which demands decision by this Court.

THERE IS NO CONFLICT WITH PRIOR DECISIONS OF THIS COURT.

Petitioner claims conflict with *Security Mills Co.* v. *Commissioner*, 321 U. S. 281 (1944); *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516 (1944); and *Lucas* v. *American Code Co., Inc.*, 280 U. S. 445 (1930). There is no conflict. The two Courts of Appeals involved have merely declined to extend the rule of these cases beyond its reason. With reference to these three cases the Seventh Circuit in the instant case said:

> "In all the above-cited cases, there was only a single claim being contested. In such a situation, it is obvious that (1) there may or may not be liability depending on the outcome of the contest, and (2) the amount of the liability is quite often uncertain.
>
> "In the present situation there are numerous claims,

and assuming at this point that in the aggregate the amount of liability is predictable, neither of the above reasons for not allowing a deduction is pertinent. * * * this is not a situation where there may or may not be liability, depending on the outcome of the contest. * * * If overall liability can be accurately predicted, there should not be any objection to the fact that it cannot be tied down securely in any particular claim." (Petition Appendix A, pp. 56-57; 283 F. 2d 279, 286-287.)

The Second Circuit reasoned similarly in *Ocean Accident & G. Corp.* v. *Commissioner*, 47 F. 2d 582, 584.

"Each one, viewed alone, would be too contingent as to payment and too uncertain as to amount to be deductible as a 'loss sustained.' *Lucas* v. *Am. Code Co.*, 280 U. S. 445, 50 S. Ct. 202, 203, 74 L. Ed. 538. But the question is whether the aggregate of estimated unpaid losses for any year may not be taken as an aggregate of accrued losses, though each one separately, or at least most of them, would be contingent and unpredictable. * * * Here the accrued losses were predictable with remarkable accuracy, the business of petitioner being large enough to disregard the contingencies inherent in each loss taken alone. To assimilate such a situation to a single loss is, in our opinion, to close one's eyes to the substance of the business. We do not think the American Code Case so requires."

Petitioner also cites as in conflict *Brown* v. *Helvering*, 291 U. S. 193 and *U. S.* v. *Anderson*, 269 U. S. 422. To the contrary, the difference between those two cases, and the reasoning of both of them, illustrates exactly why the instant case involves a deductible accrual rather than a non-deductible reserve. The question in *Anderson* was whether an accrual basis taxpayer ought to deduct its 1916 munitions tax in 1916, as the Government there contended, or in 1917 when it was settled and paid. In deciding for

deduction in the earlier year, this Court laid down the famous "all events" test.

> "In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and become due; but it is also true that in advance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's books." (269 U. S. 422, 441.)

It was perfectly clear in the context of the case that this Court was there talking about a situation in which the operative facts have actually occurred although their meaning or even existence may be subject to future arguments; that it is *not* required that the *determination* of liability shall have occurred; that what *is* required is that the *events* shall have occurred *from which* the liability is determined.

> "By the close of the year, liability for the tax had become definitely fixed, the tax being based on the result of operations for 1916 * * * neither liability for the tax nor the amount properly payable could be affected under the law by anything occurring after December 31, 1916. * * * The fact that a difference of opinion might arise after December 31, 1916, between the taxpayer and the Commissioner of Internal Revenue as to what was a reasonable depreciation on plant and equipment, or as to other items of that nature, did not provide new factors occurring after December 31, 1916, varying the tax." 269 U. S. 422, 425-426 (Argument for the United States).

> "A consideration of the difficulties involved in the preparation of an income account on a strict basis of receipts and disbursements * * * indicates with no uncertainty the purpose of Sections 124(a) and 13(d) [ss 446, 1954 Code] * * * to enable taxpayers to keep

> their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period * * *.
>
> "The appellee's true income * * * could not have been determined without deducting from its gross income for the year the total cost and expenses attributable to the production of that income during the year." 269 U. S. 422, 440 (Opinion of the Court).

That the crucial question is the occurrence of the *events* which determine liability, not the determination itself, accords with the Government's own historical and never revoked position, I. T. 2500, VIII-2 CB 103 (1929), and has recently been expressly reaffirmed by this Court. *Lucyt Corp.* v. *Commissioner*, 349 U. S. 237, 243.

Brown v. *Helvering*, 291 U. S. 193, illustrates the distinctly different situation of an attempt to deduct a reserve against liability which will arise from the occurrence of events in the future—there, cancellation of policies. The distinction is not in the degree of certainty but rather in the time of occurrence of the operative facts. Mr. Brown was attempting to predict how many of his policyholders *would* cancel in the future; but they had not done so yet, whereas the events giving rise to the munitions tax liability in *Anderson* and the traffic accidents giving rise to the taxpayer's injuries and damages liabilities in this case had indisputably occurred prior to the end of the years in question beyond man's power to change them.

There is a further distinction between the instant decision and *Brown* v. *Helvering* in that the *Brown* case involved a *change* of accounting method from that employed in previous years. In such situations the plenary power of the Commissioner to accept or reject the change is well known and statutory (§ 446 (e) IRC 1954).

"The annual method of accounting had been gratuitously

> employed by Edward Brown & Sons before 1923, but no "return commissions" account had been set up * * *. In assessing the deficiencies, the Commissioner required in effect that the taxpayer continue to follow the method of accounting which had been in use prior to the change made in 1923. To do so was within his administrative discretion * * * 291 U. S. 193, 203.
>
> "This proposed alternative method of computing the income * * * was not employed * * * either before or after 1923. * * * The Commissioner was of opinion that the method of accounting consistently applied prior to 1923 accurately reflected the income. He was vested with a wide discretion in deciding whether to permit or to forbid a change." 291 U. S. 193, 204.

Several courts of appeals have recently indicated their belief that this "change of accounting method" feature of *Brown* is its true teaching. *Bressner Radio, Inc.* v. *Commissioner*, 267 F. 2d 520, 523; *Beacon Publishing Co.* v. *Commissioner*, 218 F. 2d 697, 701, cf. 702.

THERE IS NO CONFLICT WITH DECISIONS OF OTHER CIRCUITS.

The Petition also asserts, although with neither analysis nor explanation, that the decision below conflicts with a list of decisions in other circuits. Upon reading those cases, however, it is found that they all involve distinctly different considerations. *United States* v. *Texas Mexican Railway Co.*, 263 F. 2d 31 (CA 5) and *Commissioner* v. *Fifth Avenue Coach Lines*, 281 F. 2d 556 (CA 2) involve the outcome of a single contest—the inherently unpredictable all or nothing situation as distinguished from an aggregate of several hundred contests where the aggregate may be subject to reasonable prediction even though each single item taken separately is not.

Capital Warehouse Co. v. *Commissioner*, 171 F. 2d 395 (CA 8) and *Spencer, White & Prentis* v. *Commissioner*, 143

F. 2d 45 (CA 2) both involve deduction not of an estimate of a present liability but of an estimate of liabilities predicted to arise in the future for payment of salaries to employees to recompense them for services to be performed in the future.

Spring Canyon Coal Co. v. *Commissioner*, 43 F. 2d 78 (CA 10), bears a superficial resemblance to the instant case but in fact illustrates exactly what this taxpayer did *not* do. The Government admitted as much in the Court below. Spring Canyon Coal Co. attempted to set up and deduct a self insurance reserve equal to the amount of insurance premiums it would have paid had it not been a self-insurer. Such a technique illustrates perfectly the true reserve against events which may occur in the future. As a matter of fact the present taxpayer has on its books a similar true reserve account (wholly separate from the liability account here in controversy) which it has *not*, however, attempted to deduct for tax purposes. (Joint Exhibits 5-E, contained in the record certified by the Tax Court to the Court of Appeals but not printed.)

Finally, the Petition alleges conflict with the decision of the Seventh Circuit in *Straight Radio & Television, Inc.* v. *Commissioner*, 280 F. 2d 883, now pending on Petition for Certiorari (No. 507). The Court of Appeals, including former Chief Judge Duffy, who heard both cases, saw no conflict. The most elementary distinction is that *Straight* did not involve a deduction but an attempt to defer income and in the opinion of the Court of Appeals was governed by the decision of this Court in *Automobile Club of Michigan* v. *Commissioner*, 353 U. S. 180.

THE QUESTIONS IN THIS CASE ARE NOT CLOSELY RELATED TO OTHERS NOW PENDING BEFORE THIS COURT.

Again without explanation or analysis the Petition asserts that the question presented here is related to those involved in six cases in which petitions for certiorari have either been granted or are pending. The decisions in those cases will not control this one, or even aid in its decision. Under the applicable statutes (IRC 1954 Sec. 446, App. C., *infra*, p. 21), taxable income is to be computed in accordance with the same method of accounting the taxpayer uses for book purposes unless and only unless that method does not clearly reflect income. Only if it is determined that the method used does not reflect income, or if a change in method is sought, does the statute grant the Commissioner authority to impose a method of his own. The question presented in this and other accounting method cases (if no change of method is involved) is therefore whether the method used does or does not reflect income. Such a question is inherently factual, to be decided on the record in each case, and the decision in other cases can be helpful only where both the accounting method used and the underlying facts were essentially identical. No such comparison is possible between this case and the others pending in this Court.

Four of the cases pending do not involve deductions at all but involve instead deferral of reporting of prepaid income: *American Automobile Assn. v. United States*, No. 288; *New Jersey Automobile Club v. United States*, No. 140; *Straight Radio & Television, Inc. v. Commissioner*, No. 507; and *Commissioner v. Schlude*, No. 629. The second case in which Certiorari has already been granted, *United States v. Consolidated Edison Co. of New York*, No. 357, involves an important but very particularized and narrow conflict between the Court of Appeals for the Second Cir-

cuit and the Court of Claims over whether accrual may ever survive payment. Since the taxpayer there did not use and the Government is not contending that it should have used a method of accounting for the contested liabilities even remotely similar to the method used by this taxpayer, nor is there any showing that it could have done so, the decision in that case must necessarily rest on totally different considerations than a decision in the instant case. Lastly, the Petition names *Fifth Avenue Coach Lines, Inc.* v. *Commissioner*, No. 634. As previously noted, that case involves a single and indivisible contested liability and was decided on the basis of a rule of law found inapplicable to an aggregate of a large number of separate liabilities by both of the Courts of Appeals which have had the question.

THE DECISION BELOW IS NOT A REINSTATEMENT OF REPEALED SECTION 462.

Throughout this case, both in the courts below and still now, the Government has persistently ignored and attempted to blur the distinction between a *reserve* for future liabilities and the *accrual* of the estimated amounts of liabilities already incurred, even though Treasury Regulations expressly recognize estimated accruals. (Regs. § 1.461-1 (a) (2), App. C.; *infra*, p. 23.) The Court of Appeals expressly decided that the deduction in controversy here *was* an estimated accrual and *not* a reserve. (Petition Appendix A, p. 56; 283 F. 2d 279, 286.) The Government is entitled to attempt to persuade this Court to review the decision but it is considerably less than candid when it repeatedly characterizes the deduction as a reserve as if that were an uncontested fact rather than a rejected argument. (Petition pp. 2, 4, 6, 8.)

5. *Consolidated Edison* v. *U. S.*, 135 F. Supp. 881 cert. den. 351 U. S. 909; *Chestnut Securities Co.* v. *U. S.*, 62 F. Supp. 574.

This insistence on mischaracterizing the deduction here as a "reserve" has had several unfortunate results. Doubtless the primary effect has been to cause petitioner to overestimate the importance and general applicability of this case. Had the Court of Appeals actually permitted this taxpayer to deduct a reserve against the cost of future events, this case might merit consideration by this Court along with some of the others now pending. Since the Court of Appeals did *not* do so, the case has no such importance.

A second result of petitioner's persistence in calling this deduction a "reserve", despite the holding and fact to the contrary, is that the case is thus made to appear to contravene the Congressional repeal of Section 462 of the 1954 Code which during its abortive life authorized deduction of a reasonable "reserve for estimated expenses." It is quite true that Section 462 would have authorized a reserve for self insurance against damages claims. *Spring Canyon Coal Co. v. Commissioner*, 43 F. 2d 78, cert. den. 284 U. S. 654, distinguished *supra*, p. 14, is doubtless a good example of the type of deduction which is not, but would have been, permitted.[6] Nothing of the sort is here involved.

THE DECISION BELOW IS CLEARLY CORRECT

In opposing the Petition for Certiorari it would be fatuous of respondent to attempt a better defense of the decision below than it itself contains. It carefully analyzes, and for sound and explicit reasons rejects, every objection of the Government to allowance of the deduction in con-

6. See *Pacific Employers Insurance Co.*, 33 BTA 501. Although dealing with a statute not here applicable, the case carefully distinguishes between an unallowable reserve for losses and an allowable accrual of the aggregate estimate of liability on losses already incurred.

troversy. This taxpayer, like all taxpayers, is affirmatively required by the express wording of the applicable statute to use for tax purposes the same consistently applied recognized method of accounting which it uses in keeping its books, except only if such method does not clearly reflect its income either as a matter of fact or as a matter of law.

As a matter of fact, taxpayer's method here involved does clearly reflect its income on an annual basis, matching the expenses involved against the income of the year in the earning of which they were incurred, whereas the method sought to be imposed by the Commissioner clearly does not. Nor is there any legal exception applicable here. The exceptions relied upon by the Government have to do either with reserves against future expenses or with the impossibility of making a reasonably accurate estimate of the outcome of a specific contested claim. Neither of these has any application to the facts of this case.

In *Brown* v. *Helvering*, 291 U. S. 193, 200, this Court cited with approval *Ocean Accident & G. Corp.* v. *Commissioner*, 47 F. 2d 582, along with *United States* v. *Anderson*, 269 U. S. 422, for the proposition that a liability actually incurred during the year is a proper basis for a deduction even though the amount of the liability has not been definitely ascertained. The Court below applied identically the same rules of law as did the Second Circuit in *Ocean Accident*.

Petitioner's attempt to distinguish *Ocean Accident* by implying that the question there turned on special statutes applicable only to insurance companies demonstrates only a lack of appreciation of the question there at issue. The *kind* of deduction there was specially authorized but not the *timing* and, like the instant case, *Ocean Accident* was not concerned with *what* was deductible, but solely with *when*. The decision there did not turn on any of the special

provisions applicable to insurance companies but rather on the general definition of "accrued" applicable to all taxpayers, as plainly appears from the opinion of the Second Circuit (47 F. 2d 582) as well as from the previous (reversed) opinions of the Board of Tax Appeals. (13 BTA 1058 and 16 BTA 1213.)[7] As a reading of the reversed BTA opinions will show, all of the objections which the Government raises here by focusing on the individual claims and ignoring the aggregate were raised by the Government there by focusing on the individual claims and ignoring the aggregate.

7. The statutes the Government cites in its petition were not enacted until after the years in controversy in *Ocean Accident*. See footnote 4, p. 8.

CONCLUSION.

The instant case is not in conflict with any decision of this Court or of any Court of Appeals. On the contrary it is supported in principle by the decisions of this Court and supported directly by the decision of the Second Circuit in the only reported case ever to arise on similar facts. This case involves totally different considerations than any other now pending before this Court and would require separate plenary consideration for its decision. So far as appears either on or off the record the conjunction of special circumstances which allowed this taxpayer to qualify for the deduction in controversy is extremely rare. Such a rare situation, affecting few if any other taxpayers than the present one, and totally devoid of conflict either with the decisions of this Court or among the Courts of Appeals, affords none of the "special and important reasons" traditionally required for the exercise of certiorari jurisdiction.

It is therefore respectfully submitted that this Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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April, 1964.

APPENDIX C.

Statutes and Regulations Involved.

INTERNAL REVENUE CODE AND REGULATIONS.

IRC 1954 Section 162. Trade or Business Expenses. (a) In General. There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. * * *

IRC 1954 Section 446. General Rule for Methods of Accounting. (a) General Rule. Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) Exceptions. If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.

(c) Permissible Methods. Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) the cash receipts and disbursements method;
(2) an accrual method;
(3) any other method permitted by this chapter; or
(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary or his delegate.

IRC 1954 Section 461. General Rule for Taxable Year of Deduction. (a) General Rule. The amount of any deduction or credit allowed by this subtitle shall be taken for

the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Regulations § 1.446-1. General Rule for Methods of Accounting. (a) General rule. (1) Section 446(a) provides that taxable income shall be computed under the method of accounting on the basis of which a taxpayer regularly computes his income in keeping his books. The term "method of accounting" includes not only the overall method of accounting of the taxpayer but also the accounting treatment of any item. Examples of such overall methods are the cash receipts and disbursements method, an accrual method, combinations of such methods, and combinations of the foregoing with various methods provided for the accounting treatment of special items. * * *

(2) It is recognized that no uniform method of accounting can be prescribed for all taxpayers. Each taxpayer shall adopt such forms and systems as are, in his judgment best suited to his needs. However, no method accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. A method of accounting which reflects the consistent application of generally accepted accounting principles in a particular trade or business in accordance with accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income, provided all items of gross income and expense are treated consistently from year to year.

(3) Items of gross income and expenditures which are elements in the computation of taxable income need not be in the form of cash. It is sufficient that such items can be valued in terms of money. For general rules relating to the taxable year for inclusion of income and for taking deductions, see sections 451 and 461, and the regulations thereunder.

(b) Exceptions. (1) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation of taxable income shall be made in a manner which, in the opinion of the Commissioner, does clearly reflect income.

* * * * *

(c) Permissible methods. (1) In general. Subject to the provisions of paragraphs (a) and (b) of this section, a taxpayer may compute his taxable income under any of the following methods of accounting:

* * * * *

(ii) Accrual method. Generally, under an accrual method, income is to be included for the taxable year when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Under such a method, deductions are allowable for the taxable year in which all the events have occurred which establish the fact of the liability giving rise to such deduction and the amount thereof can be determined with reasonable accuracy. The method used by the taxpayer in determining when income is to be accounted for will be acceptable if it accords with generally recognized and accepted income tax accounting principles and is consistently used by the taxpayer from year to year. * * *

Regulations § 1.461-1. General Rule for Taxable Year of Deduction. (a) General rule— * * * (2) Taxpayer using an accrual method. Under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy. * * * While no accrual shall be made in any case in which all of the events have not occurred which fix the liability, the fact that the exact amount of the liability which has been incurred cannot be determined will

not prevent the accrual, within the taxable year of such part thereof as can be computed with reasonable accuracy. For example, A renders services to B during the taxable year for which A claims $10,000. B admits the liability to A for $5,000 but contests the remainder. B may accrue only $5,000 as an expense for the taxable year in which the services were rendered. Where a deduction is properly accrued on the basis of a computation made with reasonable accuracy and the exact amount is subsequently determined in a later taxable year, the difference, if any, between such amounts shall be taken into account for the later taxable year in which such determination is made.

(3) Other factors which determine when deductions may be taken. (i) Each year's return should be complete in itself, and taxpayers shall ascertain the facts necessary to make a correct return. The expenses, liabilities, or loss of one year cannot be used to reduce the income of a subsequent year. A taxpayer may not take advantage in a return for a subsequent year of his failure to claim deductions in a prior taxable year in which such deductions should have been properly taken under his method of accounting. If a taxpayer ascertains that a deduction should have been claimed in a prior taxable year, he should, if within the period of limitation, file a claim for credit or refund of any overpayment of tax arising therefrom. Similarly, if a taxpayer ascertains that a deduction was improperly claimed in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due. However, in a going business there are certain overlapping deductions. If these overlapping items do not materially distort income, they may be included in the years in which the taxpayer consistently takes them into account.

(ii) Where there is a dispute and the entire liability is contested, judgments on account of damages for patent in

fringement, personal injuries or other causes, or other binding adjudications, including decisions of referees and boards of review under workmen's compensation laws, are deductions from gross income when the claim is finally adjudicated or is paid, depending upon the taxpayer's method of accounting. However, see sub-paragraph (2) of this paragraph. * * *